

# Response to the Draft Report of the Productivity Commission Inquiry into the Workplace Relations Framework

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## 1. Introduction and overview

In broad terms there is much in the draft report (PC 2015) which appears to be a sensible and balanced response to the terms of reference for the Inquiry. In particular I would note that, in terms of the overall framework, the Inquiry has:

- Appropriately recognised that there are significant imbalances in the power of employers and employees in workplace relations which means *‘employees are likely to have much less bargaining power than employers, with adverse outcomes for their wages and conditions’* (p3).
- Made the right judgement in stating that *‘Australia’s WR system is not dysfunctional’* (p3).
- Correctly recognised that minimum wages are a justified element of the WR system and that the current rate of the wage is not inappropriate (p3).

In noting this I would though express a general caution about the confidence that the PC appears to have on the capacity of ‘regulation’ to balance the bargaining power of employers and employees. This reservation has many aspects and I believe it is important that when the PC proposes options in this report that it more formally assess these against the question of this power imbalance, and the extent to which any regulatory protection can and will be effective, along with who carries the burden of proof and the cost of achieving an outcome. For example, where the PC proposes approaches such as ‘individual flexibility arrangements’ (p568) and concepts of an ‘enterprise contract’ (Chapter 17), the PC should also present a more extensive, balanced discussion on how to ensure that individuals have an equal bargaining position to their employers, including protection of their ongoing employment.

While noting these positive aspects of the draft report I consider that in other respects it has some marked weaknesses and requires considerable additional work.

- Specifically I believe that much of the PC’s discussion of the minimum wage is misfounded due to an inappropriate assumption of the relationship between the minimum wage, other earnings and productivity. This has resulted in the PC ignoring the major challenges which arise when this assumption, which is contradicted by historic fact and by economic theory, is removed.
- The PC on a number of occasions appears to lapse into micro-management and has a tendency to develop the detail of possible options at a level which is not warranted either by the overall context of the inquiry being about the workplace relations framework, or by the depth of analysis and policy development which it has undertaken into the specific question.

I take the first of these issues up in the next part of this response and touch on a few aspects of the second in the third section.

With regard to the more general matters raised by the second observation, I would emphasise my response is partial only. That is I only address a few specific examples and do not attempt to consider the report comprehensively. To my mind however these examples illustrate a need for the PC to comprehensively review the whole of the draft report, with a view towards an approach which is more focused on identifying the possible problems, providing analysis which enables an

assessment of the extent to which these are actually substantive issues which do need to be addressed, and if this is the case, then proposing directions for reform and mechanisms which will allow this to be undertaken, rather than coming up with what are often less than fully developed, or balanced, approaches. The two specific examples I discuss concern weekend penalty rates and junior rates of pay.

## 2. Minimum Wage - Wages and productivity

As indicated in the introduction I consider the PC has correctly recognised the importance of the Minimum Wage, and is right in its assessment that the current rate of the wage is not inappropriate. I however consider that most of the subsequent analysis provided by the PC has limited value and has failed to tackle substantive issues because the PC has erroneously based its analysis on an assumption that: *‘Over the long-run, it could be expected that minimum wages would grow approximately in line with economywide productivity levels and maintain a roughly fixed ratio to median wages.’*(p333)<sup>1</sup>

If this statement is correct then it points to a very benign situation where the minimum wage can be set broadly in line with changes in productivity of the Australian economy and the earnings of other employees, with potential minor temporary adjustments away from this path, in the short term, in response to more immediate economic circumstances.

I however do not think this is the case and I consider this statement, on the basis of Australian data over the past four decades, to be incorrect empirically and unsupported theoretically, and that this way of thinking has effectively led the Productivity Commission to ignore the hardest questions about the future of the minimum wage. Taking these in turn:

### Empirical evidence

Even on the data provided in the Draft Report it is clear that the statement does not reflect the past experience in Australia. On page 291 the PC reports:

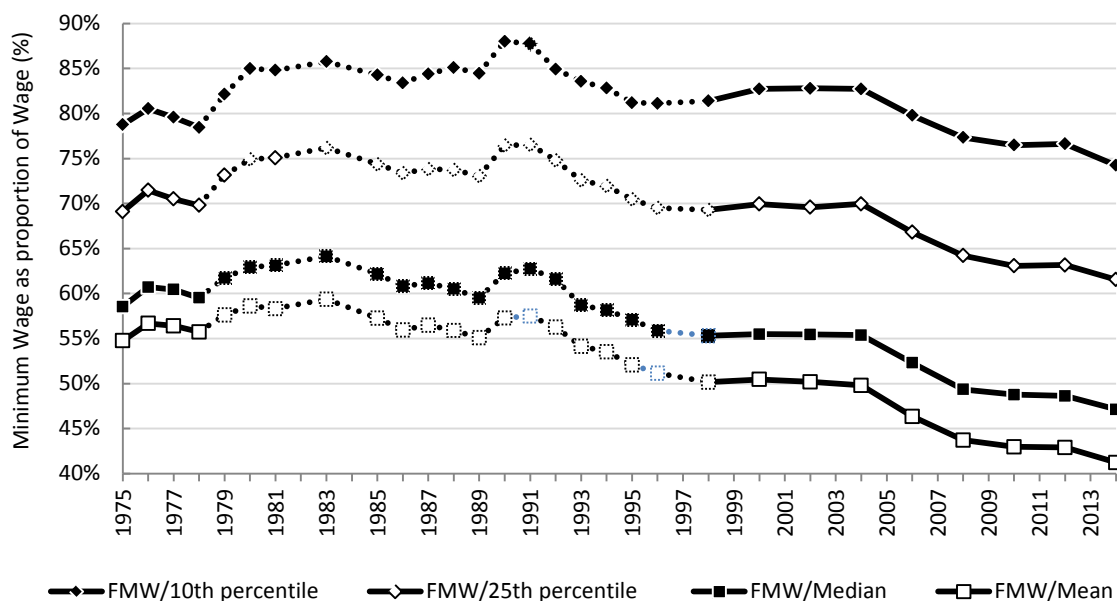
the bite of the minimum wage in Australia has declined significantly over time. Between 2004 and 2013, the bite fell from almost 60 per cent to less than 55 per cent ... This followed an earlier, more gradual, decline: Australia’s minimum wage bite exceeded 65 per cent during the recession of the early 1990s ... Median earnings increased by 12 per cent in real terms over the period 2004–2013. The minimum wage was also increased throughout this period (except in 2009), with its real value having grown 4 per cent by 2013.

This scarcely appears to provide evidence of the hypothesised relationship, rather it reflects the strong and consistent evidence that the minimum wage has grown at a rate significantly below earnings as a whole.

Looking at the relationship over the long term, Figure 1 below, shows the Minimum Wage as a proportion of earnings at points of the distribution between 1975 and 2014. The wages series are from the ABS Survey of Employee Earnings and Hours, and are the earnings of Full-Time Adult non-Managerial employees.

<sup>1</sup> This assessment is repeated in the Overview as: *‘it could be expected that long-run minimum wages would grow approximately in line with economywide productivity levels and maintain a roughly fixed ratio to median wages.’* (p15) The relationship is also restated in the shorter term as *‘Heightened unemployment and underemployment rates provide stronger grounds to moderate the growth rate of the minimum wage to below the growth in median wages (which ultimately themselves reflect rising trend labour productivity growth in the economy)’* (p331–332).

**Figure 1: Relativity of Minimum Wage to points in the distribution of weekly earnings of Full-Time Adult Non-Managerial Employees, 1975-2014**



Source and notes: Employee earnings derived from ABS Survey of Employee Earnings and Hours (Cat. No. 6306.0), various years. Minimum wage from Bray 2013 revised and updated. Metal Workers minimum wage series shown as dotted line between 1979 and 1999<sup>2</sup>.

Over this period, as illustrated, the value of the minimum wage has fallen from 58.6 per cent of median earnings of Full-Time Adult non-Managerial Employees to 47.1 per cent; it has fallen from 54.8 per cent of the average wage of this group to 41.2 per cent. The minimum wage has also declined relative to other measures of low income – falling from being 69.1 per cent of the 25<sup>th</sup> percentile of earnings in 1975 to 61.5 per cent in 2014.

Even over the shorter term, since the introduction of the FMW in 1997, the decline relative to the median has been from 55.3 per cent in 1998 to 47.1 per cent in 2014. Relative to average earnings the decline has been from 50.2 per cent in 1998 to 41.2 per cent in 2014.

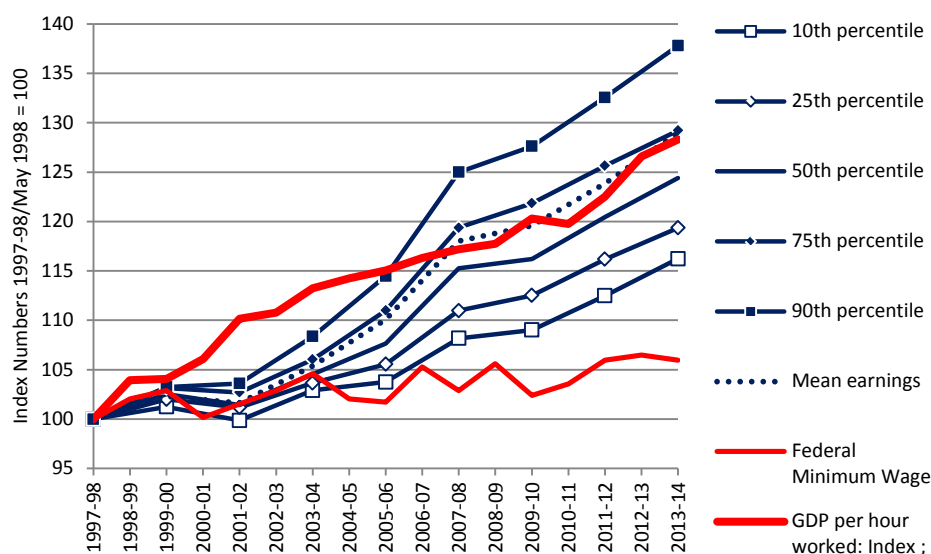
Using average weekly ordinary time earnings for all adult employees from the AWE series the decline is from 51.5 per cent in May 1997 to 42.8 per cent in May 2014.

Figure 2 presents more recent trends in the growth of real earnings at different points of the earnings distribution and the real minimum wage, along with productivity, as reflected in GDP per hour worked, over the period since 1997-98<sup>3</sup>.

<sup>2</sup> The reasons for using the Metal Award series are discussed in Bray 2013.

<sup>3</sup> This time period has been chosen as, while the Federal Minimum Wage was established in April 1997, the ABS Employee Earnings and Hours Survey is only undertaken every two years and hence the May 1998 survey has been used as a starting point. Similarly ABS only publish the GDP per hour worked series for June 1979 onwards and, given the divergence at that time between the ‘residual minimum wage’ and the minimum wage paid under the Metal Workers Award, which became the basis of the Federal Minimum Wage, it was felt that a series commencing on the basis of this award level may have been inappropriate.

**Figure 2** Relative real growth of the Minimum Wage, points in the distribution of weekly earnings of Full-Time Adult Non-Manual Employees and productivity 1997-98–2013-14



Source and notes: Employee earnings derived from ABS survey of Employee Earnings and Hours (Cat. No. 6306.0), various years, adjusted by all groups CPI. Minimum wage from Bray 2013 revised and updated. GDP per hour worked: Table 34. Key Aggregates and analytical series, Annual, ABS Cat No 5206.0 Australian National Accounts: National Income, Expenditure and Product, March 2015.

This data shows very clearly that the minimum wage, ‘over the long run’, has not increased at the same rate as other points of the income distribution and that, while ‘over the long run’ average earnings have kept pace with productivity growth (or in fact average total effective remuneration may have slightly exceeded this as there was some increase in the rate of the Super Guarantee over this period) this is not the case for the median or points in the distribution below this, let alone for the minimum wage. The reason for these latter results, as can be seen in the chart is the strength of earnings growth at the top of the income distribution<sup>4 5</sup>.

To restore the minimum wage to its 1975 relativity with median earnings, for example<sup>6</sup>, it would need to be increased by around a quarter, and to relativity with mean earnings, it would need to be increased by a third. If the PC is committed to its observation on page 333: ‘*In improved economic circumstances, minimum wages would catch up to restore their long-run ratio to median wages*’,

In addition it is noted that the Minimum Wage has been plotted on the basis of its value in May of each year. While in some years this was just after an award increase, in other years it was before the next increase. The impact of this, while generally marginal, means that alternative estimates of the rate of growth of the minimum wage, using the dates of application rather than consistent points in time, will be higher.

<sup>4</sup> It should be noted that as this data only provides the distribution of non-managerial employee earnings, it hence should not be taken as being indicative of changes across the workforce as a whole.

<sup>5</sup> Of course the other implication of the PC statement of wage rates moving consistently in accord with productivity is that one should see no divergence in wage rates. This issue was considered by Greenville, Pobke & Rogers (2013) who report increased rate of inequality and that: ‘*At the individual level, the key drivers are the widening dispersion of hourly wages of full-time employees*’ (p2).

<sup>6</sup> As discussed in Bray (2013, p13-14), prior to the 1970s the relativity of the minimum wage to other earnings was significantly higher, indicating that the use of 1975 is not a ‘high point’.

does this imply that it see a need for the minimum wage to increase by a quarter or more as soon as the economy improves?

## Theory

The standard classical micro-economic explanation of a wage rate is that, for any one person in a perfect competitive market, it equates to the marginal revenue product for their employer from the person's employment. The marginal revenue product in turn is the volume marginal product of the worker and the price of the product. Productivity in turn measures the volume of output relative to the volume of inputs – or at the individual level, their marginal product<sup>7</sup> per hour worked.

In such a perfect market it could be expected that any improvement in the productivity of an individual worker would be reflected in their own wage rate. In an accounting sense both of these gains, that is in the additional product from the person's higher productivity, and in the individual's wage, can be aggregated to indicate an improvement in productivity across firms a whole and in average wages. There is however no basis to assume that this change in average productivity would, or should, be distributed across all workers. Rather if one worker, or one group of workers, increased their own productivity this would be reflected in their individual earnings. Indeed it would be expected that the distribution of productivity gains, and the wage benefits, would be highly uneven across the workforce. This is particularly the case where productivity may be associated with technological innovation and favours workers with particular skills<sup>8</sup>.

Of course where the market is not perfect there are many factors which may see some of these gains spread more widely. For example an employer may not be able to identify the relative contribution of a number of employees performing similar tasks and will average wages across them. Alternatively some productivity gains may come from an overall change in technology or organisational change and be distributed more widely. Collectively workers may decide to trade off higher wages for some, for a more even distribution of earnings (see for example Card, Lemieux & Riddell 2004). Alternatively a wage structure may be imposed through some industrial determination which for a variety of reasons may compress the wages distribution or introduce some other distortion. These factors do not however provide any basis for expecting productivity gains to be evenly distributed<sup>9</sup>. Similarly it is not possible to formulate, a priori, a general

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<sup>7</sup> In this discussion I am disregarding price impacts as these are not germane to the basic principle although they may contribute to second round and other effects (for example an increase in productivity may result in a lower price of the product with the gain being spread through the original and other sectors for which the product is an input). Similarly I will leave to the side productivity/efficiency wage arguments (Yellen 1984) which suggest an opposite causality. That is, of higher wages being paid to some workers to stimulate higher levels of productivity. Very clearly in this latter case the productivity is tightly associated with the individual employee remuneration. This has been identified by Booth and Frank (1999) who look at the role of performance related pay (PRP) in the UK and conclude this boosts male earnings by 9.3 per cent and that of women by 5.6 per cent and concludes '*the earnings differential equals the average productivity gains from PRP, net of monitoring costs at the marginal firm using PRP*' (p461–2).

<sup>8</sup> There is a considerable literature on this question, including debate on actual mechanisms and disagreement as to the extent such change has contributed to increased wage inequality over recent decades. See, for example: Acemoglu & Autor (2011), Card & DiNardo (2002), Machin (2008) and Steelman & Weinberg (2005).

<sup>9</sup> In 2001 Mitchell et al reported that in Australia '*wage earners are not being fully compensated for productivity increases and sectoral productivity, in particular is playing a minor role in wage outcomes. In*

equilibrium, or long term, outcome from a productivity shock in one sector as this will depend, amongst other factors, on the relative elasticities of demand for products in different sectors.

In the draft report the PC specifically relates changes in average productivity to changes in median earnings. Given the above, there are no grounds for postulating this. Rather the only potential generalised relationship would be with average earnings. This misspecification has been directly addressed by Mankiw (2006):

Average productivity is best compared with average real wages. If you see average productivity compared with median wages or with the wages of only production workers, you should be concerned that the comparison is, from the standpoint of economic theory, the wrong one.

## Implications

Essentially by postulating a benign labour market in which *‘minimum wages would grow approximately in line with economywide productivity levels and maintain a roughly fixed ratio to median wages’* the PC positions its findings in a context where the primary questions around the minimum wage relate to the short term.

In taking this position I consider that the PC has not addressed the substantive issues with regard to the future of the Australian minimum wage. As I have detailed in my submission (Bray 2015) and associated material (Bray 2013), and as illustrated above, over many decades the growth in the minimum wage has been well below that of other earnings. Specifically I note:

- a) This in large part reflects the wage moving from its role as a family wage to one for an individual.
- b) This has been achieved without significant negative well-being outcomes as a consequence of increased government support for those families with dependent children reliant upon the wage, increased labour force participation within families, and the extent to which the family wage element of the wage was protective of single persons.
- c) This process has meant there has been little wages pressure on the labour market from the minimum wage.
- d) The scope for this process is coming to an end.

Given this, there exists a set of options available for the future development of the minimum wage in Australia. I would suggest that central amongst these are:

- a) Setting the minimum wage in line with increases in overall earnings.

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*contrast ... sectoral wage increases in the Netherlands are more closely linked to sectoral productivity changes’.*(p10) Hibbs and Locking (2000) track the impact of wages policy in Sweden and suggest that while policies of equal pay for equal work were productivity enhancing, excessive compression of earnings had a negative impact on productivity.

- b) Setting the minimum wage, as above, so that it increases in line with other earnings, but take action to seek to ensure that the productivity of individual minimum wage workers increases in line with overall productivity gains across the economy.
- c) To maintain the minimum wage around its current value in real terms, or increase it at a lower rate than other earnings, taking into account the specific changes in the productivity of minimum wage workers.
- d) To maintain it in real terms/increase it at a lower rate, as above, and seek to maintain the relative living standards of minimum wage workers through other interventions such as an EITC.

Option a), essentially the path implied by the PC approach, has the highest risk of adverse labour market outcomes in terms of potential exclusion of some from employment. While this may be mitigated in option b) through activities to boost the productivity of those on the minimum wage, such as additional training or other support (for example addressing health or other disadvantages), I have considerable reservations as to whether this can effectively boost the productivity of all of these workers over the long term. While a range of active labour market programs have been utilised extensively in many countries, the evidence of their impact does not inspire confidence that they can effectively respond. As reported by Heckman et al (1999) *‘these programs usually have at best a modest impact on participants’ labor market prospects ... there is considerable heterogeneity in the impact’* (p1866)<sup>10</sup>. In addition there is also the question of the funding of such interventions.

Options c) and d) best characterise the Australian minimum wage since the mid-1970s with the wage rising just 16.1 per cent over a 40 year period<sup>11</sup>. (As previously described, since the establishment of the Federal Minimum Wage in 1997, the real value of the wage grew by 6.1 per cent between May 1998 and May 2014, compared with growth of 24.5 per cent in median earnings and 29.0 per cent in average earnings.) While option c) best describes the experience of persons without children, option d) has effectively been the scenario for families with dependent children.

As I indicated in my original submission, I consider that responding to this challenge in the short term is not the critical question, but rather what is important is that the question be recognised and that a process is put in place which would permit the issues and options to be examined more closely and which would be designed to build a consensus around a future approach, including identifying the roles and responsibilities of all sectors, including government. In the interim the wage setting processes should have as a priority the maintenance of living standards and building an environment of trust and cooperation in looking at the longer term challenge.

<sup>10</sup> While there is an extensive literature on the evaluation of active labour market programs, this is mainly concerned with programs directed at the unemployed and where the primary objective is to boost employment and labour market attachment. Recent analysis of these programs include Kluve 2010, Lechner, Miquel and Wunsch (2011), Card, Kluve and Weber (2015). More specific research also exists on the impact of vocational and related education with this more frequently identifying the income effect. While much of this reports positive impacts on income (and hence provides some insight into the extent to which these approaches may boost the productivity of minimum wage workers), the question of the distribution of these gains is less evident. This is critical to the question of the minimum wage.

<sup>11</sup> May 1974 to July 2015.

The role for the PC in this inquiry is, I believe, to clearly identify the need for a longer term strategy and the mechanisms needed to support it, both in terms of the short to medium term, wage setting and family support policies, and in the longer term examination of options and responses.

## Other Minimum wage and related issues

### Rationale for the minimum wage

The draft report claims that much of the initial rationale for the minimum wage have been ‘*largely rendered redundant*’ (PC 2015 p327), specifically citing ‘sweated labour’ and the ‘family wage’. This sweeping statement requires revision. Taking the family wage concept it needs to be recognised that this was not the rationale for the minimum wage per se, but rather the criteria adopted by Higgins to determine the level of the wage. This is a marked and significant difference.

Turning to the question of ‘sweated labour’ I consider that it is totally inappropriate to treat this as a concern of the past. It is rather a key issue which continues to require a strong and well enforced minimum wage. As I indicated in my submission ‘*unconstrained market mechanisms can, and indeed did and do still today, produce some extremely poor outcomes.*’ (Bray 2015, p7) I document this further in footnote 13 (p11) citing just three of the cases reported by the Fair Work Ombudsman (FWO) in February 2015, relating to significant underpayment of staff. A simple perusal of the work of the FWO with respect to the action it has needed to take to address actual cases of exploitation, along with reports such as the one into the Baidada Group, one of the two major Australian poultry processing companies, (FWO 2015)<sup>12</sup>, strongly suggests that the tendency towards ‘sweated labour’ continues today and provides a key rationale for interventions such as the minimum wage, as well as enforcement by agencies such as the Fair Work Ombudsman. The false impression left by the existing statement that this type of exploitation is a relic of the past, needs correction.

### Representation of interests of the unemployed

The draft report discusses on pages 330-31 the question of the identification of the needs of the unemployed in decisions on the minimum wage. While it is somewhat unclear as to where this discussion leads in the draft report, it would be appropriate for the PC to note that:

- a) The minimum wage objective as specified in the Act specifically identifies the responsibility of the FWC to take account of ‘*the need to promote social inclusion through increased workforce participation*’ (Fair Work Act 2009 (Cth) s 134(1(c))), and as is implicit in this, consideration of the needs of the unemployed is an integral part of any considerations of the FWC and in the research undertaken (see for example the decisions discussed below); and
- b) The Australian Government has particular responsibilities both in terms of economic and labour market policy, and financially, for the unemployed and as such the interests of the unemployed are part of the matters it should appropriately raise in the government’s submission to Annual Wage Reviews.

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<sup>12</sup> This report notes for example ‘*Workers were paid between \$11.50 and \$13.50 per hour for shifts of up to 19 hours and were not paid any leave entitlements or provided payslips*’. (FWO 2015, p20)

If the PC considers that the Australian Government is either unable or unwilling to represent the interests of this group, this should perhaps be stated more directly. If this is not the case, then it would be appropriate for the discussion to better reflect the extent to which these matters already form part of consideration in minimum wage decisions.

## Discussion of prudent policy, FWC approach and recommendation 8.1

The introduction to this discussion (PC 2015, p331) should again reference the fact that the FWC already has a responsibility, as cited above, to take into account the needs of the unemployed. The existing wording: *‘These considerations suggest that the FWC should give significant weight to employment impacts of [sic] when determining the level of the minimum wage’* carries with it the implication that this is something the commission should do, not something that it actually currently does. It is my understanding that the Commission takes this criterion seriously with this being seen in the 2014 Annual Wage Review. This decision had some 76 references to ‘unemployment’ and ‘unemployed’ in it, and in indicating it’s assessment of this area the Commission reiterated its agreement with the statement made in the previous 2012-2013 decision, which in turn emphasised agreement with the 2009–10 Review decision which stated *‘Our view is that the low paid need the highest level of wages that is consistent with all other objectives including low unemployment, low inflation and the viability of business enterprises.’* (FWC 2014, p17–18) This is very clearly giving this matter ‘significant weight’.

The PC discussion of this issue concludes with a proposal that the FWC *‘should broaden its analytical framework to systematically consider the risks of unexpected variations in economic circumstances on employment and the living standards of the low paid’*. (p334). In coming to this position the PC suggests ‘arguably’ that the FWC should asymmetrically bias its decisions to minimise any risk of ‘overshooting’<sup>13</sup>. It seeks to illustrate the concept of risk using some fan charts produced by the

<sup>13</sup> The PC would appear to have not fully worked through the logic of this approach of attenuating each wage round by the downside risk only. Say in a steady state where the FWC propose an increase of  $x$  in period 1, but discount it for an amount of  $\alpha$  because of the downside risk so as to give a wage equal to  $w_0 + (x - \alpha)$ , in the next period the tribunal would have two options.

- The first is that it restores the amount of discount in the first period (since the possible downturn did not occur) but, again take account of the downside risk, hence setting the wage at  $w_0 + (x - \alpha) + \alpha + (x - \alpha) = w_0 + 2x - \alpha$ . Over time, in this steady state, the only effect of the policy would be in the long term to reduce the absolute level of the minimum wage by the initial  $\alpha$ . That is the future wage in period  $n$  would be equal to  $w_0 + nx - \alpha$ .
- The alternative would be not to compensate in each wage round for the discount which has inappropriately been made in the previous wage decision. This would see the wage cumulatively reduced in each wave by  $\alpha$ , even if in the steady state there was no change in the risk. Effectively producing a wage, in period  $n$ , equal to  $w_0 + nx - n\alpha$ , where the  $n\alpha$  represents the accumulated discounts for risks that did not eventuate. Very clearly there is no basis to impose such a cumulative discount to account for current risk.

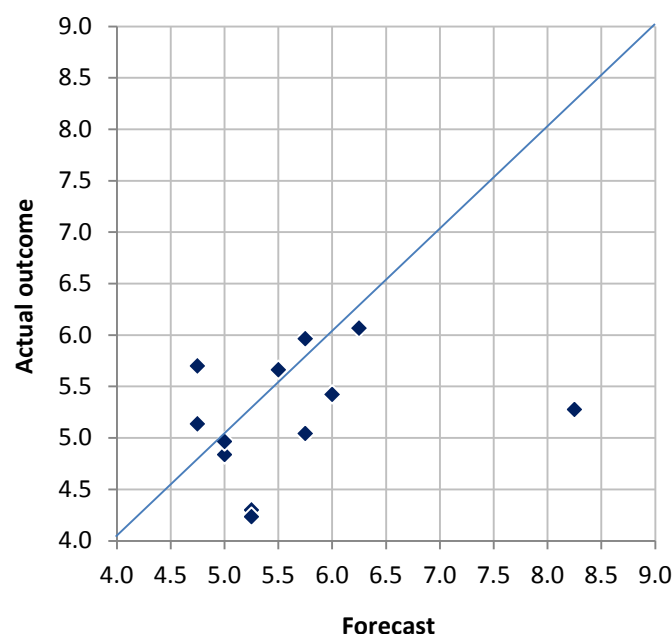
It is totally unclear what the rationale of either of these approaches would be. The first would simply reduce the ongoing minimum wage by an amount equal to the risk factor in the first period, whereas the second would apply an ongoing discount to the minimum wage which is not associated with current risk.

It would seem equally implausible, if there was an economic downturn, for the FWC to be able to decide to grant an increase in the period which ignored the impact of this, on the basis that it had already discounted the wage in an earlier period to take account of the possibility of this downturn having occurred.

Bank of England. The report does not however discuss the limitations of these forecasts. Using the August 2015 chart (BoE 2015, p6) with an unemployment rate of around 5.6 per cent in December 2014, it forecasts an unemployment rate in June 2015 of between some 4.3 per cent and 6.8 per cent.<sup>14</sup> It is difficult to see, in this timescale the actual additional value of this forecast – besides that unemployment might go up or it might come down in a fairly wide band. Further, with respect to this chart, the BoE notes that *‘In the later part of the forecast period, a significant proportion of this distribution lies below Bank staff’s current estimate of the long-term equilibrium unemployment rate. There is therefore uncertainty about the precise calibration of this fan chart’* (p7), suggesting that the spread of possibilities shown in the chart are not a realistic set of forecasts. While not discussed in the draft PC report the obvious question is who would improve upon the BoE methodology, produce such forecasts, and provide additional resources for this activity. It would appear however that such an activity should be undertaken by the Treasury or the Reserve Bank both of which have already considered the issue (Clark et al 2013 and Tulip & Wallace 2012), but that the decision would also need to take account of the wider value and costs of this approach. Of course both of these bodies already have the capacity within the existing framework of Annual Wage Reviews to provide such material to the FWC for use in its considerations.

A further question concerns the extent to which the problem of error in forecasts is a major issue that needs to be dealt with. Figure 3 plots the Budget forecasts of the unemployment rate (for the June quarter of the following year) from 2003-04 to 2014-15, against actual unemployment rate outcomes.

**Figure 3: Unemployment rate: Budget forecast relative to actual outcomes 2003-04 to 2014-15**



Source and notes: Forecasts from Budget Statement 2: Economic Outlook, Table 1: Domestic economy forecasts, Budgets 2003-04 to 2014-15, Outcomes Table 1. Labour force status by Sex, Australia - Trend, Seasonally adjusted and Original, ABS Cat No 6202.0 Labour Force, Australia, July 2015

<sup>14</sup> These are approximate figures as they have been taken from the chart graphic which has an imprecise scale.

This chart would suggest that on the whole the budget forecasts have tended to be either accurate or on the pessimistic side. The one case in which the forecast severely underestimated the unemployment outcome was in 2008-09 – associated with the GFC, which surely has to be seen as a very long tailed event. This would also suggest that the PC concern is more theoretical, rather than highlighting a major weakness in current arrangements.

Taken as a whole it would appear that the discussion by the PC on this issue tends to understate the extent to which the FWC already takes account of unemployment, and overstates the risks associated with using mean forecasts and where the proposed solutions have significant limitations. In addition, a matter not discussed by the PC is, as also noted in the following item, that a high proportion of the considerations of the FWC in decisions are retrospective. That is, the decision is taken on the basis of what has happened over the period since the previous decision, rather than being prospective.

### **Minimum wage – variations**

As detailed in the draft report and discussed in my submission, the case for State or regional variation in the minimum wage is very weak, and the introduction of such a policy would cause many more inconsistencies and problems than it would apparently resolve. It is however difficult to understand why the PC considers that there should be an extension of the scope for ‘*temporary variations ... in exceptional circumstances*’ (p350) which currently can be raised prior to an annual decision but not in the period following until the next annual review. The PC suggests that the provision for only allowing this consideration prior to a decision and not afterwards is an anomaly which needs to be addressed. In the discussion of this the PC cites, as an example of such exceptional circumstances, a natural disaster. I would argue that the anomalous situation relates not so much to the issue of pre and post variation, but rather the provision itself. To the extent the current provision exists it can most probably be best seen as a means of ensuring that some localised situation is not used as grounds for arguing against a national change. That is, as a technical device.

To expand it as a general provision with retrospective scope seems inappropriate:

- a) To the extent there may be a localised exceptional circumstance, such as a natural disaster, the use of the wages mechanism to provide compensation seems to be a strange approach, both in terms of appropriateness relative to other means of compensation, such as disaster relief (by way of grants and loans to those affected by the calamity which can be directly targeted at those affected and targeted appropriately to the circumstances), and in terms of the impact of a marginal reduction in the wages of some employees relative to the overall impact of a natural disaster.
- b) In such a circumstance it also seems to be very unclear as to why a group of low paid employees should be the group which needs to carry the burden of a policy response to the problem.
- c) The use of such a mechanism would raise a set of highly complex boundary issues – both by location and by industry. This in turn would introduce considerable inefficiency into decision making, and considerable additional costs for all parties, and in all likelihood would generate an outcome which would be at the margins, or more generally, crude and arbitrary.

In addition, this type of approach ignores the extent to which wages decisions are primarily retrospective, as discussed above, largely being argued on the basis of changes in productivity, prices and profitability over the preceding period, as well as the role of the wage system in providing long term stability.

As such, rather than trying to resolve one of the small odd features in the workplace relations framework, and a minor inconsistency, this proposal seems to build upon this to create a larger anomaly, as well as obscuring the question of how best to respond to natural disasters and similar events, including the impact on local industry, and indeed other industries that might be affected in one way or another.

## **Discussion of Distributional aspects of earnings from the minimum wage**

### **Minimum wage – junior rates**

The PC raises the question as to whether there should be changes to the structure of Junior Pay. I would consider that there is a strong case to do so. I will not go into much detail but would note:

- It is clear from Figure 9.6 (p353) that the current junior wage scale is not consistently applied and there are considerable differences by award. There seems to be few grounds from the data to believe that the pattern reflects marked differences in the relative productivity of differently aged workers in the different sectors.
- The discussion of the situation in OECD countries requires a less selective and more sophisticated analysis rather than just the current observation that *‘around 50 per cent ... set youth wages as a share of the adult rate’* (p351). A perusal of the data (OECD 2015) shows:
  - In those countries where age specific rates apply, the most common age at which the adult rate applies is age 18.
  - The rates which apply at particular ages tend, with the one exception of the Netherlands, to be significantly higher than in Australia.

Clearly if this material is to be drawn upon, there is scope for more sophisticated comparative analysis both of wage structures and employment outcomes across these countries to better understand the possible implications, if any, of change.

- Initial comparison of unemployment rates between New Zealand and Australia by age<sup>15</sup>, for people aged under 30 years, does not suggest any major distortion in the level of youth unemployment in New Zealand relative to Australia. For example the NZ unemployment rate for 15-19 year olds, in June 2015, is 1.10 times that of Australia, while the rate for the 20-24 age group and the 25-29 year age group is 1.19 times. This suggests that relatively these older age groups face higher disadvantage, rather than the younger group which in NZ is also eligible for the adult minimum wage. I would note that this is simply indicative of there being no simple or

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<sup>15</sup> New Zealand data from Statistics New Zealand (2015), Australia from ABS 6291.0.55.001 - Labour Force, Australia, Detailed - Electronic Delivery, LM2.

immediately robust relationship and that more detailed analysis is required to draw conclusions<sup>16</sup>.

- Particular attention needs to be given to the pay rates of people aged 18 years and over:
  - In this regard I note the PC states it does not concur with the argument that adult rates should apply to people when they achieve adulthood – at age 18. The only rationale proposed for this in the draft report appears to be the posing of a question as to whether this would price some people out of jobs or attract some people out of education.
  - I would consider that there are in fact a range of questions which need to be asked and the responses balanced. The first, and I consider the most important, is whether or not these workers are as productive as those aged over 21 years who are undertaking the same jobs. Not only does this question provide strong grounds for the absolute basis for a decision, but also identifies the other, missing, half of the PC argument on the pricing out of some groups from employment. That is, the payment of low rates to this younger age group, if they are equally productive, tends to inappropriately price out potential employees over the age of 21. A second issue, in this case providing a counterpoint to the question of attracting people out of education, is whether higher pay rates for those aged over 18 will enable a higher proportion of those who combine school and work to remain in education by providing more sufficient incomes. These issues reiterate the need for the PC to carefully consider all of the impacts of policies and not just, as is frequently the case in the current draft, a selection which can inappropriately slant discussion in a particular direction.
  - The approach of setting rates for those aged under 21 years as a proportion of Adult rates, and trying to understand the rationale of this, becomes absolutely farcical for those aged 20 years of age where this proportion is 97.7 per cent of the Adult rate. (A proportion which is equally echoed in the PC proposal in table 9.2.) It really seems to be absurd to judge that this group of adults is, as a whole, 2.3 per cent less productive than those aged 21 years and over, and as such should be paid 2.3 per cent less.

Essentially I consider that the PC is correct to identify this as an area that does need to be addressed as part of a more rational workplace relations system. I do not however think that the PC has been able to undertake sufficient analysis to develop a viable option, although I do consider an approach which considers both age and experience is likely to better proxy productivity than one based on age alone. On this basis a more appropriate finding by the PC may be that there is a problem, and that the most appropriate response is the development of a simple structure which takes account of both age and experience, along with a recommendation that the FWC develop such an approach.

In commenting on the question of youth I would also note that I agree strongly with Recommendation 9.2 concerning apprenticeship and training, I would add to the list of subjects proposed for the review questions about the quality of training and transferability of skills, and the implications of Trade Support Loans including on future expected rates of earning for tradespersons.

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<sup>16</sup> A particular issue in NZ are the high rates of unemployment amongst Maori people, 12.6 per cent and Pacific people 11.3 per cent, compared to 4.3 per cent for those with a European ancestry. Full analysis needs to account for, amongst other matters, the distribution of these populations by age.

## Minimum wage – in work benefits

As detailed in the first part of this response I consider that the PC has avoided considering the long term future of the minimum wage, the fact that it has fallen behind other earnings, and there is a need to consider the extent to which this path will continue to be taken, and if so, whether there is a need for policies which may limit inappropriate living standard outcomes.

As I detailed in my original submission, this for the main part is not an issue that needs to be resolved in the short term, but it is an issue that needs to be understood and for this inquiry to provide some direction as to the way it can be responded to.

In this regard I consider the discussion on in work benefits in the draft report to be inadequate and the appeal in the ‘Information Request’ to be misdirected. In addition I am deeply concerned by the narrow coupling of the discussion, totally ignoring the extent to which family payments currently provide in work benefits. In this regard it seems odd that the PC only seems to recognise that the system exists in the context of comments such as *‘In an Australian context, any EITC would also interact with a well-developed tax-transfer system, which is also intended to improve the incomes of the low paid’* (p329), but then it pays absolutely no attention to this system, nor how it currently interacts with the minimum wage. This is a large blind spot in the draft report.

In contrast to the rather abstract question posed by the PC of what an in work benefit *‘might mean for future minimum wage determinations’* (p385), I consider the PC should be starting from a position which recognises that the minimum wage, and indeed other low rates of pay, have fallen significantly relative to other earnings, and which notes that the potential adverse social consequences of this have been addressed for families with children through increased transfer payments and higher workforce participation in couples, and that single people, while experiencing a decline in their relative living standards, have been protected by the high base from which the relative decline commenced. The PC then needs to realistically face up to the fact that the claim it makes regarding the capacity of the minimum wage to maintain relativity with other earnings is historically false and highly unlikely to be the case into the future. In doing this it becomes clear that it is not a question of the implications of an EITC or some similar transfer payments for the minimum wage, but rather a question about the implications of the likely future trajectory of the minimum wage for the well-being of low paid Australians, and the policy response which is needed to this.

I consider that I have provided in my initial submission considerable detail of the matters that need to be considered in developing approaches and will not repeat them here, however I would emphasise it is not about the detail of *‘optimal design’* but much more about how we manage a process which will permit the options to be developed.

As noted above one aspect of existing in work benefits which are not discussed in the PC report are family payments. I consider this to be a significant oversight as these are policies which are already in place and which require attention. Not only has the minimum wage fallen behind other earnings, but a number of recent decisions by successive Australian Governments has meant that family payments, which have for some 30 years been the main source of increased income for low income working families with children, and have largely been responsible for this group being able to maintain their living standards relative to others, have stopped playing this role. The initial decision which has given rise to this was the breaking in July 2009 of the longstanding link between Family

Tax Benefit Part A and increases in earnings, through a benchmarking against the pensioner couple rate, with the payment only being indexed by movements in the CPI from this time. This meant that instead of this payment increasing in line with real income growth across the workforce, it simply held its value. More recent proposals including the freezing of Family Tax Benefit for two years from 2015 and the initial reduction, and then non-indexation, of the Family Tax Benefit supplement will further exacerbate this. A full review of the impact of these policies and the implications of them for the relative living standards of low paid workers would appropriately fit into the discussion of in work benefits in this report.

### **Presentation of Harvester as a dispute**

In the Chairman’s address at the time of the release of the draft report he cast the origins of the Australian industrial relations system in terms of *‘serious and at times violent disputation’*, going on in the next sentence to discuss the Harvester decision as *‘And another dispute gave birth to the concept of a minimum wage - a sum sufficient for a working man to support his family and settled by a court’*. (Harris 2015) This characterisation is misleading. The case was in fact, as stated by Higgins in the introduction to his judgement: *‘an application by H. V. McKay for a declaration by the President that the conditions as to the remuneration of labour in the applicant’s factory were fair and reasonable’*. (Higgins 1907) Effectively it was an application from an employer to the tribunal for a declaration which was required so that they could demonstrate that they should be able to obtain an exemption from an excise tariff that was being imposed by the Commonwealth Government.

While I recognise this is a rather arcane issue to raise, and does not impact upon the draft report per se, I do think it is important that the PC does report history accurately.

### 3. Other matters

#### Draft recommendation 3.2, 3.3 & 3.4

More as an observation rather than specific commentary on the detail, I would note that these recommendations appear to be getting into a level of micro-management of the activities of the Commission. This I consider detracts from the wider function of the PC Inquiry and its focus on the system as a whole. Further, to the extent the PC has not, as I understand it, undertaken a detailed internal management review, it is possible that the prescriptive proposals such as those in the draft may not be entirely feasible. I note, for example, while reference is to ‘merit-based performance review’ there is no discussion of what the specific criteria would be, and indeed whether a set of merit criteria can even be established which would provide a balanced insight into Commissioners’ work<sup>17</sup>. The context of the recommendation is that of underperformance, and it would be more sensible for the focus of recommendations to be on this. Besides this, I would note that details of the specific time periods for reviews and the staggering of these, etc, again reflect this level of micro-management.

To the extent the PC is recommending that appointments be for a limited time period it should also be considering what are the appropriate mechanisms to ensure independence – which along with experience is a reason for favouring long appointments. One such approach may be requiring people to accept post appointment exclusionary periods on employment in sectors which may otherwise benefit from commission decisions. My view is that if the recommendation for relatively short term appointments is made in the final report then it needs to also contain recommendations along the above lines.

In the case of the appointment panel (Recommendation 3.2) it is unclear why people involved in industrial representation or advocacy would be excluded. Indeed I would consider having a panel of people who have been involved in these roles, from diverse perspectives, including ‘from opposing sides of the fence’, would be amongst one of the stronger basis for ensuring that the panel recommends people who are seen as being unbiased. Similarly the suggestion that *“It should be a requirement that panel members should have experience in board or senior executive selection”* (p154) would seem to bias the panel towards the public sector (experience in senior executive selection) and corporate sector (board selection). Such a bias is inappropriate.

#### Draft recommendation 4.2

I consider that this recommendation again has a strong element of micro-management in it. State Governments may decide to introduce public holidays for a wide range of reasons. In taking such a decision one of the issues these governments need to take account of is the impact on industry in their State relative to others, as well as the cost they themselves will have to bear because of the

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<sup>17</sup> While measures of volume and timeliness can be relatively easily formulated, adjusting these for the relative complexity of cases, becomes much more complicated, and developing performance based criteria to measure independence, creativity and mediation skills and application are a real challenge, let alone measuring ‘soundness of judgement’. If this proposal is to be maintained these questions need to be tackled.

decreased work undertaken by their own employees, and potential penalty payments to some. This I would consider imposes an internal balance upon their decision making and generates a high level of accountability.

Given that the policy is not likely to generate additional accountability, then the question is what impact will it have? In all probability in most industries eventually (after much posturing and potentially some disputation – all of which comes with a cost to industry and employees) the additional day will be paid, leaving a small group excluded. The question is whether this outcome is worth the cost?

### Draft recommendation 14.1

The PC has correctly identified that there is a significant lack of consistency and rationale in the pattern of penalty rates. From the analysis presented in the report while I agree this is the case I do not think that there is however a strong basis for the specific recommendations made in the report. In particular:

- The report confuses the situation in much of the discussion. For example, in Figure 7 on page 26, it describes the casual loading of 25 per cent as a ‘penalty’. This is highly misleading. The casual loading is not a penalty rate but rather is compensation for a lack of conditions, in particular leave entitlements, which are payable to a non-casual employee. It is surprising that the PC does not appreciate this difference.
- The data on the evidence for change is less than convincing and indeed, effectively the PC position on page 522 is formed primarily on theoretical argument rather than empirical evidence. While the theoretical position is not invalid – it is not an argument which proves the case as it could equally relate to absolute wage levels, or any penalty rate at all – and does not specifically address the appropriate level for penalty rates<sup>18</sup>, especially as for many workers the effective differential which the PC describes as being a ‘significant size’ is just 20 per cent<sup>19</sup>.  
More specifically:
  - Table 14.5 (page 519) suggests considerable variation in opening hours within Australia by location which the PC does not seek to explain by variations in penalty rates, although suggesting that the difference between Australia and New Zealand is. This appears to be a

<sup>18</sup> The PC presentation of its argument is summed up as “*The Productivity Commission’s overall view — informed largely by the reality that labour demand responds to wage rates — is that as there is a significant differential between Saturday and Sunday penalty rates, their greater alignment is highly likely to have sizable employment effects.*” The report then goes on to say this position is not based on a ‘*simple adoption of any assumption that employment is highly responsive to wage rates*’ but rather it is about the size of the differential. This latter qualification does nothing to limit the fact that the position simply is one of an assumption that employment is responsive to wage rates, and that the PC considers, for example, the additional 20 per cent wage cost for those under the Fast-Food Industry Award, and Restaurant Industry Award on a Sunday relative to the Saturday, is so high that it has a major negative impact on employment.

<sup>19</sup> The other half of this equation of course is the elasticity of demand on Sundays relative to Saturday – if consumers have a preference for shopping on Sundays, which this proposal seeks to respond to, then there are reasonable grounds to expect that they will be willing to pay more or accept a lower standard of service on a Sunday relative to a Saturday – or indeed a weekday – and this should be taken into account.

selective approach to the interpretation of data. At the very least it suggests that there is a need for much more rigorous analysis to be undertaken by the PC in order to draw any conclusions.

- There is no substantive justification for the proposal to simply reduce the Sunday penalty rate, rather than looking at what may be an appropriate weekend penalty rate. Essentially the proposal appears to be arbitrary rather than considered.
- The focus on just some limited sectors of the economy ‘selected consumer services’ is not justified. If there is a trend to a seven day consumer economy, which is the justification given in the draft report, why isn’t a much wider focus being taken? I would note for example the case of the NSW motor traders position:

Motor Traders’ Association of NSW seeks an amendment to the Shop Trading Act 2008 to prohibit motor dealers trading on Sunday. This is an important issue to motor dealers as this is causing a great difficulty in the sector to recruit quality sales staff. This also extends to the difficulty businesses have in retaining female sales staff that have families as working Sunday is difficult as no childcare facilities are available on Sundays. (MTA NSW 2015)

In the absence of any systematic approach to this question it would appear that the PC is responding to the special pleading of one industry sector rather than laying out any broader national strategy to consider this matter. This latter is what I consider should be the focus of a review into the framework.

- With respect to the restaurant and café industry it is also worth noting that this (along with some of the more upmarket accommodation sector) are the main industries that recognise that they do not pay an efficiency wage, but rather have a strong expectation that consumers will pay an additional amount as a tip to ensure appropriate levels of service from their staff. Under these circumstances it cannot be considered that the basic rates of pay are excessive.

The PC is correct to identify that there is a case for the current arrangements for weekend penalty rates to be reviewed to ensure that they more appropriately reflect this disutility of weekend work. One element of this may well be a higher degree of consistency between Saturday and Sunday penalties – although as I note in a number of sectors, the additional labour cost on Sundays, relative to Saturday, is a relatively modest 20 per cent. The approach in the draft report is however partial and a substantive basis for the actual proposal is severely lacking. It would be rather more appropriate for the PC to make a recommendation for a more substantive review which can consider the questions in more detail and develop a more coherent set of responses.

### **Internships and unpaid work experience (Information Request page 739)**

This is an important issue, and on the basis of anecdotal material, research such as Stewart and Owens (2013) and international experience it would appear to be a matter which needs to be addressed.

As indicated by the PC a major problem with this type of arrangement is the lack of information. In large part this can be ascribed to the lack of regulation of this activity and the relative power imbalance within the relationship.

Noting this I am unconvinced by the arguments in the draft report on page 738 about factors that ‘*limit the extent of the problem*’. Specifically:

- While it can be argued as the PC does that ‘*Once the promises that are used to procure the efforts of unpaid workers lose their currency, there is little to keep them at a company*’ (p738), this statement fails to address the fact that a person may have spent several weeks, months, or even a year effectively providing their labour for free before they discover that the promise (which may be spun out by the employer) is not going to be fulfilled. At the end of this period few would have the resources, either financial or time, to pursue action to obtain redress, despite the fact that they may have incurred a significant financial cost, either through supporting themselves, or through forgone earnings. The PC in advancing this argument totally ignores the losses, including the opportunity cost, incurred by people up to the point where they discover that the promise is not kept.
- Similarly, while the issue of business reputation is important, it is hardly a guarantee of legal or ethical business conduct. If it were the case there would be no need for a range of legal and other enforcement activity – including as has been highlighted the work of the FWO, and more generally in the areas of consumer protection and the enforcement of contracts. It seems unreasonable to suggest that this area of activity can be left to this mechanism.

It is beyond the ambit of this response to go into details of specific options for dealing with this issue, but it would be appropriate for some further inquiry to be instigated to examine approaches<sup>20</sup>. These could include, for example, improved legislation or other regulatory activity which would provide an appropriate framework for this type of activity to operate in, and measures such as standard contracts which cover matters such as the duration of any work experience, the obligations of the employer and of the person participating, including the actual benefits and experience to be provided, the provision of appropriate occupational health and safety coverage, and any specific commitments to future employment as well as certification that the intern is not undertaking the duties of a regular employee. There would also be scope for ensuring that all such arrangements are registered in a way which would enable systematic patterns of abuse to be identified.

A further issue to be considered is the inclusion of work experience placements/internships in the ABS Labour Force survey program – for example, including questions on whether people have undertaken any of these activities in the past 12 months, and the details of such placements, as part of the Participation, Job Search and Mobility supplementary survey.

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<sup>20</sup> An issue, while potentially beyond the ambit of this inquiry, but of relevance to these internships is the impact of this type of arrangement on social equity and equal employment opportunities. If unpaid internships become the entry point for employment, or some particular forms of employment (especially as they are being also used with respect to some ‘prestige opportunities’), then this favours those who have the financial means, or whose parents have the financial means, to support them during the internship.

## Data issues (pages 821-823)

In the key points summary to chapter 26 the PC notes:

There is a paucity of both data and related research on the labour market and impacts of changes to the WR framework over time in Australia. Future analysis of Australia’s WR framework would benefit from better data sets and a deeper Australian economic literature examining the effects of different elements of the WR system. (p801)

Notwithstanding this, the draft report does not contain a specific recommendation for how this is to be achieved or identifying the need for additional funding to enable the work to be done.

In addition, while the report identifies some element of a ‘future research agenda’ this only addresses a small number of, quite frequently, micro level questions<sup>21</sup> and does not address the broader gaps in data and data availability. A large number of these gaps have been noted in other aspects of the report and will have become apparent to the PC in its work. As I cited in my original submission a major area relates to earnings, and in particular the severe problems of even identifying the size of the minimum wage workforce from current statistics.

There seems to be a strong case for the PC to consider this question across all of its considerations in this review to make specific recommendations concerning the need for improved labour force data in a number of areas and for the provision of adequate funding to appropriate bodies to enable the collection and analysis of this. In addition, it should be addressing questions such as the greater availability of administrative data which would enable research into labour related questions.

It is unfortunate that in this draft report while the text makes reference to the PC recommending a research agenda this is not identified as either a possible recommendation or as an information request.

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<sup>21</sup> As an example the PC identifies in the list of questions: ‘*Research comparing the earnings of employees under 16 in New Zealand and Australia.*’ (p822) In the light of the massive gaps in other areas pertaining to the workforce more widely (for example, identifying the number of people in receipt of the minimum wage, understanding the labour dimensions of Sunday trading – including firm attitudes, the incidence of internships, etc), this does not appear to be a key priority.

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